Securities And Exchange Commission v. Heinen et al Doc. 19

MARC J. FAGEL (Cal. Bar No. 154425)
fagelm@sec.gov
ROBERT L. MITCHELL (Cal. Bar No. 161354)
mitchellr@sec.gov
MARK P. FICKES (Cal Bar No. 178570)
fickesm@sec.gov
SAHIL W. DESAI (Cal. Bar No. 197358)
desais@sec.gov

Attorneys for Plaintiff
SECURITIES AND EXCHANGE COMMISSION
44 Montgomery Street, Suite 2600
San Francisco, California 94104
Telephone: (415) 705-2500
Facsimile: (415) 705-2501

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. NANCY R. HEINEN, Defendant.	Case No. C-07-2214 (JF) **JOINT CASE MANAGEMENT STATEMENT** Date: September 7, 2007 Time: 10:30 a.m. Location: Courtroom 3, 5th Floor Hon. Jeremy Fogel

Pursuant to the Northern District's Standing Order and the Court's order dated July 11, 2007 (Docket No. 13), plaintiff Securities and Exchange Commission (the "Commission") and defendant Nancy R. Heinen ("Heinen") submit this Joint Case Management Statement.

1. JURISDICTION AND SERVICE

This is a civil enforcement action brought by the Commission alleging fraud, in violation of the federal securities laws. The Commission brings this action pursuant to Sections 20(b) and 20(d) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77t(b) and 77t(d)] and Sections 21(d)

Dockets.Justia.com

and 21(e) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u(d) and 78u(e)].

The Court has jurisdiction over this action pursuant to Sections 20(c) and 22(a) of the Securities Act [15 U.S.C. §§ 77t(c) and 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. § 78aa]. The Commission alleges that Heinen, directly or indirectly, has made use of the means and instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange in connection with the acts, practices and courses of business alleged in this complaint.

Venue is proper in this District pursuant to Section 22 of the Securities Act [15 U.S.C. § 77v], and Section 27 of the Exchange Act [15 U.S.C. § 78aa]. Heinen resides in the Northern District of California, and acts or transactions constituting violations occurred in this district.

There are no issues regarding personal jurisdiction or venue, and there are no other parties to be served.

2. FACTS

A. Plaintiff's Description of the Case

This case involves the Commission's allegations of improper stock option backdating at Apple Computer, Inc. ("Apple" or the "Company"), which resulted in the Company's issuance of false financial statements that concealed millions of dollars in executive compensation. On two occasions in 2001, Apple issued large option grants to top executives, but used allegedly false grant dates to avoid reporting nearly $40 million in expenses to the public. The Commission alleges that defendant Heinen, Apple's then-General Counsel, caused the options to be backdated and altered company records to conceal the fraud. The Commission further alleges that Heinen personally benefited from the backdating, receiving several million dollars in improper, unreported compensation as a result of the backdated options.

Under well-settled accounting principles in effect throughout the relevant period, Apple was not required to record an expense in its financial statements for options granted at the market price ("at-the-money"), but *was* required to record expenses for any options granted below the current market price ("in-the-money"). The Commission alleges that, in order to provide herself and other Apple executives with far more lucrative in-the-money options, while avoiding having to inform shareholders of the millions of dollars in compensation expenses, Heinen twice engaged in a scheme to grant in-the-money options while falsifying records to make it appear that the options had been granted at-the-money.

The first instance was in February 2001, in connection with a grant of 4.8 million options to a group of senior officers who were members of Apple's Executive Team (the "2001 Executive Team grant"). The Commission alleges that Apple's Board of Directors did not authorize this grant until on or about February 7, 2001, when Apple stock closed at $20.75 per share. However, Heinen caused Apple to prepare false paperwork that showed the Board's approval dated as of January 17, 2001, when Apple stock was trading approximately $3.94 per share lower. Heinen personally benefited from the backdating, receiving 400,000 in-the-money options as part of the 2001 Executive Team grant, all of which she later exercised.

The second instance was in December 2001, in connection with a 7.5 million-share grant to Apple Chief Executive Officer Steven Jobs (the "2001 Jobs grant"). The Commission alleges that the Compensation Committee of Apple's Board of Directors fixed the terms of the grant to Jobs on or about December 18, 2001, when Apple stock closed at $21.01. However, Heinen caused Apple to create false paperwork, including fictitious minutes for a phony "Special Meeting" of Apple's Board of Directors, which made it appear that Board had approved the grant on October 19, 2001, when Apple stock was trading approximately $2.71 lower.

B. Defendant's Description of the Case

Ms. Heinen categorically denies the charges lodged against her by the SEC. Ms. Heinen was not aware that the accounting treatment applied to the stock option grants in question was incorrect; she did not falsify any corporate records; she did not conceal any material information from the auditors or investing public; and she did not know that the financial statements filed by Apple contained materially false statements or omissions, as the SEC has alleged. Further, Ms. Heinen denies that she possessed the necessary scienter to violate any of the securities laws – including, among other things, the requisite knowledge of the pertinent accounting rules and the resulting impact of those rules on Apple's financial statements. Finally, Ms. Heinen denies that the alleged accounting errors were material to Apple's financial statements, to the investment decisions of ordinary investors, or to Apple's stock price.

C. Principal Facts in Dispute

The defense believes that the principal issues of fact in dispute will likely be: (1) whether Ms. Heinen acted with the requisite scienter to violate the securities laws; (2) whether Ms. Heinen created any allegedly "false" documents; and (3) whether any "measurement date" accounting errors for the option grants in question were material to Apple's financial statements and/or stock price.

3. LEGAL ISSUES

The parties do not dispute the elements of the alleged violations. As a general matter, however, the parties anticipate a dispute over whether Heinen has the requisite scienter to establish liability for fraud and whether the transactions alleged in the complaint are material within the meaning of the federal securities laws. These are essentially mixed questions of law and fact.

4. MOTIONS

There are no motions pending. Plaintiff may move for summary judgment at the conclusion of discovery. In addition, Ms. Heinen anticipates filing a motion for summary judgment at the close of discovery.

5. AMENDMENT OF PLEADINGS

The parties do not expect to add or dismiss any parties, claims or defenses.

6. EVIDENCE PRESERVATION

Some of the relevant evidence in this case consists of paper and electronic documents in the possession of Apple or its outside auditors, KPMG. Both Apple and KPMG are aware of the Commission's pending lawsuit against Heinen and the need to maintain evidence relevant to this case. In addition, the Commission sent formal document preservation requests to Apple and KPMG on August 28, 2007.

7. DISCLOSURES

On July 27, 2007, the parties exchanged initial disclosures pursuant to Federal Rule of Civil Procedure 26. In its disclosures, the Commission identified 20 people likely to have discoverable information that it may use to support its claims, an index to all ten boxes of documents it previously obtained from Apple, and an index to all six boxes of documents it previously obtained from KPMG and six CDs of electronic files it previously obtained from KPMG. On July 30, the Commission produced all of these documents to Heinen's counsel, who had them copied and electronically scanned.

In her initial disclosures, Heinen identified 49 people likely to have discoverable information that she may use to support her claims or defenses. In addition, she identified certain documents that she may rely on, consisting of documents that she previously produced in response to a Commission administrative subpoena and documents previously produced to the Commission by Apple.

8. DISCOVERY

The parties have agreed on many aspects of their discovery plan, but have not been able to agree on two key issues. First, the parties disagree as to the number of depositions both sides will be entitled to notice without seeking further leave from the court. Plaintiff proposes a limit of 12 depositions for each party, whereas defendant proposes a limit of 45 depositions per party. Second, the parties have not been able to agree on a discovery schedule. The respective proposed discovery schedules are set forth in greater detail below.

To date, there has been no discovery in the case. On August 16, 2007, the Commission issued deposition subpoenae and a deposition notice for the testimony of three witnesses, including Heinen. The earliest of these depositions is scheduled for November 7, 2007.

A. Plaintiff's Discovery Proposal

The primary areas on which discovery will be needed are the factual circumstances surrounding the two options grants at issue in this case (the 2001 Executive Team grant and the 2001 Jobs grant), and Heinen's knowledge of the accounting rules relating to options, including the general accounting impact of granting an in-the-money option. This discovery can be accomplished efficiently through depositions of people who dealt with Heinen in the process of granting options to Apple's senior executives, including certain members of Apple's Board of Directors; members of the Board's Compensation Committee; senior Apple officers; and Apple's outside accountants and attorneys. Consistent with our belief that discovery can be conducted quickly and efficiently in this matter, the Commission has already noticed the depositions of the defendant and two other individuals.

The Commission does not request any limitations or modifications of the discovery rules, with one exception. The Commission offered to stipulate with the defendant to exceed the limit of 10 depositions per party as set forth in Rule 30(a)(2)(A)(i) of the Federal Rules of Civil Procedure Rule. The Commission believes that as there are only two option grants at issue in this litigation, 24 depositions will be more than sufficient. On the other hand, Heinen essentially proposes an unprecedented 90 depositions to be taken in the next 11 months.

The Commission also proposes the following discovery schedule:

Last day for fact discovery: April 23, 2008

Last day to identify expert witnesses: April 23, 2008

Last day to complete expert discovery: May 23, 2008

B. Defendant's Discovery Proposal

The SEC has spent more than a year investigating allegations of stock option "backdating" at Apple. During this time, the SEC not only had its own investigative resources to draw upon, but also the full cooperation of the company and its corporate counsel, as well as an outside law firm and forensic accounting firm who jointly conducted their own lengthy internal investigation and thereafter briefed the SEC on the results of more than 26,500 person-hours spent reviewing more than 1 million documents and conducting more than 40 interviews of current and former directors, officers, employees, and advisors. Moreover, unlike the typical civil plaintiff, the SEC has had the unique power to compel the production of documents and to subpoena witnesses for deposition – without prior permission from the court, and without the imposition of any numerical cap.

Despite these rather substantial powers and resources, the SEC twice approached Ms. Heinen before suing her to request more time to finish its investigation without running the risk of exceeding the statute of limitations. In both instances, Ms. Heinen voluntarily agreed to the request and granted the SEC a total of *seven additional months* to complete its investigation. At no time did Ms. Heinen seek to place any limits on the number of witnesses the SEC could depose.

Having completed its investigation – unfettered by scheduling constraints or numerical limitations – the SEC now seeks to limit Ms. Heinen to just 12 depositions and refuses to accommodate her request for an additional *four months* of fact discovery beyond the period the SEC claims to be necessary. Given the scope and technical complexity of the alleged corporate malfeasance at issue, such a limitation would unfairly constrain Ms. Heinen's ability to properly and thoroughly investigate the case against her and prepare the vigorous defense to which she is entitled.

In its initial disclosures, the SEC identified 20 individuals likely to have discoverable information relevant to its claims. Before even receiving the initial production of 90,000 documents from the SEC, Ms. Heinen identified and disclosed the names of 49 individuals likely to have discoverable information. Unsurprisingly, these include the range of individuals involved in the stock option granting, administration, accounting, and disclosure processes – including current and former Apple board members who authorized the grants, the grant recipients themselves, other members of senior management, employees from the relevant departments at Apple (finance, stock administration, human resources, legal, treasury, etc.), and outside professionals, such as the auditors from KPMG and corporate counsel from Wilson Sonsini.

At this early stage in the discovery process, Ms. Heinen's best good-faith estimate is that she will require approximately 45 depositions to properly investigate the claims against her and prepare her defense. Ms. Heinen also recognizes that a number of documents important to her defense might raise claims of attorney-client privilege that could generate time-consuming litigation, as has happened in other similar cases. Such litigation could serve to delay the receipt of necessary documents and thus delay the scheduling of depositions. The discovery schedule proposed by the defense allows sufficient time to resolve any disputes and conduct the necessary depositions in an effective and orderly fashion.

9. CLASS ACTIONS

Not applicable.

10. RELATED CASES

Heinen is a defendant in another case before the Court, *In re Apple Derivative Litigation*, Case No. 5:06-cv-041228 (JF). The complaint in that case alleges that Apple engaged in a pattern of improper options backdating from 1993 to 2001 (including the 2001 Executive Team grant and the 2001 Jobs grant at issue in this case), and names some 20 defendants. Because of the differences in the scope of the illegal conduct alleged and the defendants named, neither the Commission nor Heinen believe that the Commission's enforcement action is related to the derivative litigation for purposes of Local Rule 3-12.

11. RELIEF

The Commission seeks the following relief:

a. Injunctive Relief: An injunction against Heinen from directly or indirectly violating Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)] and Sections 10(b), 13(b)(5), and 16(a) of the Exchange Act [15 U.S.C. §§ 78j(b), 78m(b)(5), and 78p(a)], and Rules 10b-5, 13b2-1, 13b2-2, and 16a-3 thereunder [17 C.F.R. §§ 240.10b-5, 240.13b2-1, 240.13b2-2, and 240.16a-3], and from aiding and abetting violations of Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act [15 U.S.C. §§ 78j(b), 78m(a), 78m(b)(2)(A), 78m(b)(2)(B), and 78n(a)] and Rules 10b-5, 12b-20, 13a-1, 13a-13, and 14a-9 [17 C.F.R. §§ 240.10b-5, 240.12b-20, 240.13a-1, 240.13a-13, and 240.14a-9] thereunder;

b. Officer and Director Bar: An order prohibiting Heinen, pursuant to Section 21(d)(2) of the Exchange Act [15 U.S.C. § 78u(d)(2)], from serving as an officer or director of any entity having a class of securities registered with the Commission pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78*l*] or that is required to file reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. § 78*o*(d)];

c. Disgorgement: An order directing Heinen to disgorge unlawful profits. The amount of disgorgement may require detailed factual analysis and expert opinion.

d. Penalties: An order imposing civil monetary penalties on Heinen, pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)].

12. SETTLEMENT AND ADR

The parties have met and conferred regarding an ADR plan and have filed a Notice of Need for ADR Phone Conference (Docket No. 15). An ADR phone conference has been set for September

5, 2007 ay 3:00 p.m. At present, the Commission and Heinen believe it will be necessary to develop the facts through discovery before there can be any real chance to settle the case. The parties recommend that the Court refer this case for a settlement conference with a judicial officer at a date after the completion of discovery and motions for summary judgment, if any.

13. CONSENT TO MAGISTRATE JUDGE

The parties do not consent to proceed before a magistrate judge.

14. OTHER REFERENCES

The Commission and Heinen do not believe this case is suitable for binding arbitration. However, as noted above, the parties recommend that a settlement judge be appointed following the completion of discovery and motions for summary judgment.

15. NARROWING OF ISSUES

The parties have not yet identified any issues that can be narrowed by agreement or motion.

16. EXPEDITED SCHEDULE

This case is not suitable for expedited scheduling.

17. SCHEDULING

A. The Commission's Proposed Schedule:

Last day for fact discovery: April 23, 2008

Last day to identify expert witnesses: April 23, 2008

Last day to complete expert discovery: May 23, 2008

Last day to file dispositive motions: June 6, 2008

Pre-trial conference: September 2, 2008

Trial: September 8, 2008

B. The Defendant's Proposed Schedule:

Fact Discovery Cut-Off: Friday, August 29, 2008

Disclosure of Expert Witnesses and Reports: Friday, September 5, 2008

Disclosure of Rebuttal Expert Reports: Monday, October 6, 2008

Expert Discovery Cut-Off: Friday, November 7, 2008

Dispositive Motion Deadline: Monday, November 24, 2008

Pretrial Conference: Friday, February 27, 2009

Trial: Monday, March 2, 2009

18. TRIAL

The case will be tried to a jury. Plaintiff estimates the trial will take approximately 10 days and the defendant estimates it will take 14 days.

19. DISCLOSURE OF NON-PARTY INTERESTED ENTITIES OR PERSONS

As noted above, Heinen is also a defendant in *In re Apple Derivative Litigation*, which concerns numerous alleged instances of improper options backdating at Apple over an eight-year period, including the two instances at issue in this lawsuit. As a result, the parties to that litigation may have an interest that could be substantially affected by the outcome of the Commission's action against Heinen. Aside from that, the Commission is not aware of any other non-parties who have a financial interest in, or may be substantially affected by, the outcome of this case.

The Commission filed a certificate to that effect with the Clerk of Court on August 27, 2007 (Docket No. 16). The defendant filed a statement to similar effect on August 30, 2007 (Docket No. 18).

20. OTHER MATTERS

None.

DATED: August 31, 2007

Respectfully Submitted,

/s/ Mark P. Fickes
Robert L. Mitchell
Mark P. Fickes
Sahil W. Desai
Attorneys for Plaintiff
SECURITIES AND EXCHANGE COMMISSION

/s/ Miles Ehrlich
Miles Ehrlich
Ismail Ramsey
Ramsey & Ehrlich
Attorneys for Defendant
NANCY R. HEINEN